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AUDITOR-CONTROLLER

**COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER**

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April 29, 2004

TO: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Brathwaite Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley 
Auditor-Controller

SUBJECT: **AUDITING DIVISION QUALITY ASSURANCE REVIEW**

Recently, my Audit Division underwent a Quality Assurance (peer) review by the San Bernardino County Auditor/Controller-Recorder's office. The review was performed as part of a cooperative effort between the audit organizations of the California counties to improve the performance of governmental internal audit groups.

These reviews are conducted in accordance with the Institute of Internal Auditor's *Standards for the Professional Practice of Internal Auditing* (Standards) which the County uses in the performance of its audit work. The Standards require that each internal audit organization undergo a quality assurance review by an independent audit organization every five years (changed from three years effective January 1, 2002). A peer review determines if the audit organization is in compliance with both the Standards and the organization's established audit policies and procedures.

The attached report on San Bernardino County's review of my Audit Division found that...

"The IA activity's environment is well structured and progressive, the Standards are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Among these tools and practices are automated audit software; frequent professional training; a good reputation within the organization and credibility with customers."

San Bernardino County did suggest we consider three recommendations to improve our audit operations. Our response to the recommendations is included as part of the report.

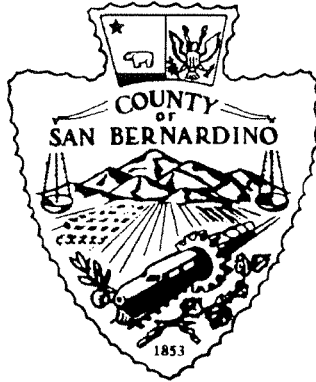
The report reflects the continued support your Board has provided over the years through recognition of our audit efforts, establishment of your Audit Committee, and your requirement for management action on audit recommendations. Audit Division members are proud of their professional excellence and appreciate the continued support of your Board, the Audit Committee, and the executive management of our client departments.

JTM:DR:RHL

Transmittal to Board.doc

Attachment

c: David E. Janssen, Chief Administrative Officer
Audit Committee



COUNTY OF SAN BERNARDINO

CALIFORNIA

**QUALITY ASSESSMENT REVIEW OF THE COUNTY OF LOS ANGELES
INTERNAL AUDIT ACTIVITY**

Office of

AUDITOR/CONTROLLER-RECORDER

AUDITOR/CONTROLLER-RECORDER COUNTY CLERK



COUNTY OF SAN BERNARDINO

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ELIZABETH A. STARBUCK

Assistant Auditor/Controller-Recorder
Assistant County Clerk

July 22, 2003

J. Tyler McCauley

Auditor Controller

County of Los Angeles

525 Hall of Administration

500 W. Temple Street

Los Angeles, CA 90012

Subject: Quality Assessment Review of the County of Los Angeles Internal Audit Activity

Objectives

The County of San Bernardino's internal audit division was engaged to conduct a quality assessment (QA) of the internal audit activity (IA activity) for the County of Los Angeles (the County). The principal objectives of the QA were to assess the IA activity's conformity to the IIA's *Standards for the Professional Practice of Internal Auditing (Standards)*, to evaluate the IA activity's effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of the County's management), and to identify opportunities to enhance its management and work processes, as well as its value to the County.

Scope

The scope of the QA included:

- Reviewing a self-study report prepared by the audit division chief and senior staff, which contained background information about the internal auditing activity, organization status, operating environment, and established departmental policies, procedures, and practices.
- Conducting interviews with the internal audit staff, the audit division chief, the third district's deputy of budget and finance, the auditor/controller and his assistant.
- Conducting an auditee survey of 17 management officials who had been audited during the three year period ended June 30, 2003, to solicit responses concerning the scope, nature, and quality of the IA activity.

July 22, 2003

J. Tyler McCauley, Auditor Controller, County of Los Angeles

Quality Assessment Review of the County of Los Angeles Internal Audit Activity

Page 2 of 6

- Conducting staff surveys to allow management to address internal areas that may need attention.
- Reviewing audit policies, procedures, practices, and information used for managing the IA activity.
- Examining a sample of audit files completed between July 1, 2002 and June 30, 2003.
- Visiting the IA activity in Alhambra, CA July 16, 17, 18, and 22, 2003.

Results

The IA activity's environment is well structured and progressive, the *Standards* are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Among these tools and practices are automated audit software; frequent professional training; a good reputation within the organization and credibility with customers. Consequently, our comments and recommendations are intended to build upon the foundation already in place.

Our recommendations are those that relate specifically to the IA activity's structure, staffing, use of resources, and similar matters that should be implemented within the IA activity, with support from senior management. Highlights of our recommendations are set forth below, with details in the Observation and Recommendations section of our report. A summary of the surveys and comments have been furnished to the IA activity.

Issues Specific To The Internal Audit Activity

1. Work paper documentation is not consistent with internal or professional standards.
2. The IA activity policy manual is out dated.
3. A formal risk assessment should be developed to assist with audit planning.

Observations and Recommendations

Implementation of our recommendations will improve the value of the service provided by the IA activity and ensure full conformance with the *Standards*.

Observation 1: Work paper documentation is not consistent with internal or professional standards.

The audit division's procedures for preparing work papers and audit documentation reflect the *Standards* but were not always followed. Seven audit files were reviewed and all files reviewed contained similar work paper and audit documentation deficiencies. The most significant issues noted were that not all work papers contained:

- Referencing from audit steps to the work performed
- Preparer initials and date
- Page numbering
- Cross referencing
- Lead sheets
- Adequate documentation of background information and preparation and planning steps
- Adequate documentation of communication with auditee during the Entrance and Exit Conferences
- Adequate documentation of the audit's purpose, scope, source and conclusions
- Documentation of support for findings
- Elements of a finding
- And, work papers were reviewed after report issuance

As a result of these deficiencies, it was difficult to substantiate audit work, audit findings, and the timely completion and review of audit work.

In addition, it was noted that audit reports are dated the day of issuance. However, Generally Accepted Auditing Standards, § 530, requires that audit reports be dated as of the last day of fieldwork.

Recommendation:

Evaluate the current guidance provided to staff and the coordination with management for the planning, conducting, reporting, and following-up on audit findings. Reinforce the audit division's procedures for preparing work papers and audit documentation with on-going training for management and staff and utilize the review process.

IA Activities Response:

We generally agree with the audit recommendation.

IA Activities Action Plan:

1. Audit Division management reviewed the guidance provided to staff in the Audit Division Operating and Senior Manuals and determined that although, somewhat

dated, they provide adequate guidance for staff for the planning, conducting, reporting, and following-up on audit findings. However, we will prepare and disseminate a memo to all staff reminding them of the necessity to adhere to the Audit Division's standards.

2. To improve the Auditing Division's work paper techniques we have:
 - Completed two work paper training refresher classes for Audit Division staff on manual work paper techniques.
 - Introduced a quarterly internal peer review of work papers, effective March 1, 2004.
3. The Audit Division will continue to date its audit reports on the day of issuance.

Observation 2: The IA activity policy manual is out dated.

The *Standards* suggest that, in large IA activities, more formal and comprehensive policies and procedures are essential to guide the audit staff in the consistent compliance with the IA activity's standards of performance. LA County does have a very comprehensive set of policies and procedures but they have not been update since 1995.

Recommendation:

Update the activities' policy manual to reflect its current location, personnel, policy, and professional standard changes.

IA Activities Response:

We agree with the audit recommendation.

IA Activities Action Plan:

The Audit Division plans to revise, update and combine its Operations and Senior Manuals into a single publication. We are projecting completion of this task within the next 12 months.

Observation 3: A formal risk assessment should be developed to assist with audit planning.

The *Standards* require the IA activity to evaluate and contribute to the improvement of risk management, control, and governance. In doing so, the activity should have a means to identify and evaluate significant exposures to risk, to monitor and to evaluate those exposures and the ability to monitor and evaluate the effectiveness of the County's risk

management system. The IA activity should evaluate risk exposures relating to the County's governance, operations, and information systems regarding the:

- Reliability and integrity of financial and operational information
- Effectiveness and efficiency of operations
- Safeguarding of assets
- Compliance with laws, regulations, and contracts

In addition, audit plans should prioritize departmental audits by risk based upon an annual assessment and input from senior management and the Board of Supervisors.

Recommendation:

Perform a risk assessment to identify and evaluate the County's significant exposures to risk. Develop long-range risk based audit plans annually to determine the priorities of the internal audit activity that are consistent with the County's goals. Develop processes or procedures to prioritize, evaluate, and monitor risk on an on-going basis.

IA Activities Response:

We generally agree with the audit recommendation.

IA Activities Action Plan:

1. Update the Audit Division's Risk Assessment schedule and utilize the schedule when preparing the next annual Audit Plan. The Risk Assessment schedule evaluates financial and program risks associated with each County department.
2. Continue developing an annual Audit Plan using the Division's Risk Assessment, which considers statutory requirements, funding, program mission, known internal control weaknesses, recent events, etc. Present the annual Audit Plan to the Audit Committee for review and approval. At the direction of the Audit Committee, revise the Audit Plan to include areas determined to be important to the Board of Supervisors.
3. Throughout the year, update the Audit Plan to reflect changes caused by current events and changing priorities of the Board of Supervisors.

Opinion As To Conformity To The Standards

It is our opinion that the IA activity generally conforms to the following *Standards*:

- 1000 – Purpose, Authority, and Responsibility (Charter),
- 1100 – Independence and Objectivity.

July 22, 2003

J. Tyler McCauley

Auditor Controller

County of Los Angeles

Quality Assessment Review of the County of Los Angeles Internal Audit Activity

Page 6 of 6

- 1200 – Proficiency and Due Professional Care,
- 1300 – Quality Assurance/Improvement Program,
- 2600 – Management's Acceptance of Risks, and
- The IIA's *Code of Ethics*,
with opportunities for further improvement in such areas as updating policy manuals and internal procedures and performing a formal risk assessment.

It is our opinion that the IA activity partially conforms to the following *Standards*:

- 2000 – Managing the Internal Audit Activity,
- 2100 – Nature of Work,
- 2200 – Engagement Planning,
- 2300 – Performing the Engagement,
- 2400 – Communicating Results, and
- 2500 – Monitoring Progress,

with more significant opportunities to strengthen work paper preparation and audit documentation.

We believe there is a reasonable level of conformity in the circumstances, which can be raised to general conformity to all of the *Standards* by implementation of our recommendations.

"General conformity" means that an internal audit activity has a charter, policies, and processes that are deemed to be in accordance with the *Standards*, with some opportunities for improvement, as discussed in our recommendations. "Partially conforms" means deficiencies in practice are noted that are judged to deviate from the *Standards*, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.

We appreciate this opportunity to be of service to the County of Los Angeles' IA activity. We wish to thank the staff and management for their full cooperation and assistance during the review. We will be pleased to respond to further questions concerning this report and to furnish any desired information.



Barbara K. Redding, CPA, CGFM

San Bernardino County Internal Audit Manager

Team Members:

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Yolanda Daugherty, Senior Internal Auditor

Copies to:

DeWitt Roberts, Audit Division Chief (1)
QA Review File (2)

Date Report Distributed:

April 12, 2004